BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF
AUTOMATED FINANCIAL TECHNOLOGIES **No. 10-16**
TO ASSESSMENT ISSUED UNDER LETTER
ID NO. L0297207424

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on August 9, 2010, before Sally Galanter, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Mr. Patrick Preston, Special Assistant Attorney General. Automated Financial Technologies LLC ("AFT") was represented by attorney, Mr. Ben Roybal. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. AFT is an Independent Sales Organization ("ISO") owning and operating automated teller machines ("ATM's") in New Mexico.

2. AFT's principal office is located in Albuquerque, New Mexico.

3. Mr. Rafael Gutierrez is the managing member of AFT.

4. AFT places its ATMs in casinos, restaurants, ice cream stores, hotels, and hospitals allowing individuals to withdraw cash for immediate use.

5. AFT places its funds in their ATMs for withdrawal by customers of banks or financial institutions.

6. An individual seeking to utilize AFT's ATMs for immediate withdrawal of cash must be a customer of a bank or financial institution.

7. As an ISO, AFT is not a bank or financial institution. Therefore "Networks such as MasterCard, Visa, Star, Pulse, Cirrus, Plus, require the ISO be sponsored into the Networks by a financial institution." [Taxpayer Exhibit 1]

8. AFT utilizes a software program owned by Elan Services, a division of U.S. Bank, allowing customers direct access to their bank accounts by use of a personal identification number ("PIN").

9. To withdraw cash, the customer inserts his/her credit or bank debit card.

10. The customer is led through a series of prompts by the ATM to determine if they will be able to obtain the cash.

11 The customer accesses their bank account by use of their PIN.

12. The customer can request to withdraw a maximum amount of $600.00.

13. The ATM prompt will ask if the customer wants to withdraw funds from their checking or savings account.

14. Upon obtaining a response, the prompt then notifies the customer that there will be a flat fee of $2.00 or $3.00 associated with obtaining the cash. The prompt, then, asks if the customer wishes to continue to obtain the cash.

15. Upon obtaining an affirmative response, the ATM, through use of the Elan software program, accesses the customer's bank account verifying if the customer has that amount of cash in their account.

16. If the customer's bank account shows sufficient funds are in the bank account, the ATM will provide the customer the cash.

17. When the ATM provides the cash to the customer, the customer's bank account is committed instantly and the amount received in cash plus AFT's surcharge fee is deducted from the customer's account.

18. If the bank account shows insufficient funds are in the bank account, the ATM will deny the customer the cash.

19. AFT does not charge a customer for an inquiry as to the balance in their bank account.

20. AFT's business relationship with banks is such that the banks, having deducted the amount of cash its customer received and the surcharge fee from its customer's account, will then reimburse AFT for the cash disbursed and for the surcharge fee charged by AFT within three or four days of the disbursement.

21. There are banks, such as Compass Bank, that will reimburse their customer the surcharge fee.

22. Mr. Gutierrez contracts with merchants to place AFT's ATMs in their business locations. AFT pays the businesses approximately twenty percent of the surcharge fee for the placement.

23. Elan Services provides a monthly accounting of all transactions for each ATM. [Taxpayer Exhibit 2]

24. The monthly accounting accurately reflects the number of cash withdrawal requests, the amount of cash withdrawn, the number of surcharge fees, the total amount of surcharge fees, the number of inquiries for balances in customer's bank accounts, the number of denials preventing a customer from withdrawing funds and the number of reversals correcting errors for each day of the month providing totals for each. [Taxpayer Exhibit 2]

25. All of AFT's income is from payment of the surcharge fees from customers obtaining cash from their ATMs.

26. The Department conducted a thorough audit of AFT in 2006 for the audit period of April 2000 through December 2005. [Department Exhibit A]

27. The audit was completed on December 11, 2006. [Department Exhibit A]

28. The Department determined that AFT failed to report and pay Gross Receipts Tax on the surcharge fees it was receiving from customers utilizing its ATMs for cash withdrawals.

29. On April 18, 2007, the Department assessed AFT in the amount of $41,686.10 in gross receipts tax principal and $10,884.92 in compensating tax. [Taxpayer Exhibit 3]

30. The parties agree that the compensating tax is owed to the Department.

31. The Department did not assess penalty on the gross receipts taxes. [Taxpayer Exhibit 3]

32. On April 18, 2007, the Department assessed interest on the gross receipts taxes in the amount of $18,393.44. [Taxpayer Exhibit 3]

33. As of the date of hearing in this protest, no payment has been made to the Department pursuant to the assessment.

34. On April 26, 2007, counsel for AFT requested additional time in which to file a written protest. [Department Exhibit B]

35. By letter ID: L0352823040 dated May 9, 2007 the Department granted an extension through July 17, 2007. [Department Exhibit B]

36. On July 11, 2007, AFT protested the assessment of gross receipts and interest assessed. [Department Exhibit C]

37. The grounds set out by AFT for the protest are that the assessment of gross receipts tax and interest is improper because the fees derived on funds loaned to finance withdrawals by ATM users are deductible under NMSA 1978, §7-9-61.1. [Department Exhibit C]

38. On July 19, 2007, the Department acknowledged the protest and advised AFT in Letter ID L1156601600 that "interest on any amount of tax determined to be due at the conclusion of your protest will continue to accrue at a rate of .041% per day until such liability has been paid." The letter also states that "You may make payment on a protested amount to stop the accrual of interest and penalty." [Department Exhibit D]

39. By letter dated August 10, 2010, counsel for AFT requested that he be allowed to submit proposed findings of fact and conclusions of law with the request included as Department Exhibit J.

40. On August 30, 2010 by facsimile and U.S. Mail, counsel for AFT submitted Proposed Findings of Fact and Conclusions of Law included in the record as Taxpayer Exhibit 4.

41. On August 31, 2010 by email counsel for the Department submitted Proposed Findings of Fact and of Law included in the record as Department Exhibit K.

DISCUSSION

The issue to be decided is whether AFT is liable for gross receipts tax assessed on its receipts from the surcharge fees AFT collects as a result of its ATMs supplying ready cash for customers in retail locations. AFT alleges that the fees are a flat fee as a result of a short term loan to the bank from AFT, that the receipts are charges made in connection with the loan to the bank, that the deduction allowed pursuant to NMSA 1978, §7-9-61.1 is not limited to banks or financial institutions, that the oral loan agreement is made with the bank and that the bank pays the fee to AFT. Therefore the critical factors of §7-9-61.1 establish a loan which is deductible relieving AFT of liability for gross receipts taxes. The Department contends that the fees are the result of a service provided to the customer to allow the customer to obtain immediate cash from their bank account and not a loan to the bank and therefore subject to gross receipts tax and not deductible pursuant to NMSA 1978, §7-9-61.1.

Burden of Proof. There is a statutory presumption that any assessment of tax made by the Department is correct. NMSA 1978, § 7-1-17(C) (2007); *Holt v. New Mexico Department of Taxation & Revenue*, 2002 NMSC 34, ¶ 4, 133 N.M. 11, 59 P.3d 491. There is also a presumption that all receipts of a person engaging in business in New Mexico are subject to gross receipts tax. NMSA 1978, §7-9-5 (2002); *Grogan v. New Mexico Taxation and Revenue Department,* 2003-NMCA-033,¶ 11, 133 N.M. 354,62 P.3d 1236, *cert denied,*133 N.M.413, 63 P.3d 516 (2003). Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously express in the statute, and the right must be clearly established by the taxpayer. *Wing Pawn Shop v. Taxation and Revenue Department,* 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991); *Security Escrow Corp. v. Taxation and Revenue Department,* 107 N.M. 540, 543, 760 P.2d 1306, 1309 (Ct. App. 1988). For this reason, "taxation is the rule and the person claiming an exemption must show that the exemption is within the letter as well as the spirit of the law." *Rauscher, Pierce, Refsnes, Inc. V. Taxation and Revenue Department,* 2002-NMSC-013, ¶11, 132 N.M. 226, 46 P.3d 687 (quoting *Kewanee Industries, Inc., v. Reese,* 114 N.M. 784, 791, 845 P.2d 1238, 1245 (1993). Accordingly, it is the taxpayer's burden to come forward with evidence or legal argument to show that it is entitled to the deductions claimed and that the Department's assessment is incorrect. Once the presumption of correctness is rebutted, however, the burden shifts to the Department to show the correctness of the assessed tax. *MPC Ltd. v. New Mexico Taxation and Revenue Department,* 2003 NMCA 21, P. 13, 133 NM 217, 62 P.3d 308.

Gross Receipts tax. Pursuant to NMSA 1978, §7-9-4 (2001) an excise tax equal to five percent of gross receipts is imposed on any person engaging in business in New Mexico referred to a " gross receipts tax." NMSA 1978, §7-9-3.5(1) (2007) defines "gross receipts" to include "performing services in New Mexico." There is no question but that AFT was engaging in business in New Mexico. See NMSA 1978, §7-9-3.3 (2003). The fee is the result of a service provided by AFT to the customers having sufficient funds in their bank accounts to withdraw cash by use of the ATMs. The question is whether the surcharge fee is deductible as a loan or "in connection to" a loan to the bank. New Mexico's gross receipts tax is imposed on the seller of goods and services, not on the buyer. Therefore, as AFT is providing a service, the tax is simply part of its cost of doing business. Unless AFT can show that the fee is a loan to the bank deductible under 7-9-61.1, AFT is liable for gross receipts tax on receipts from its activities in New Mexico

Deduction Provided in NMSA 1978, §7-9-61.1. AFT claims that it is entitled to claim a deduction pursuant to NMSA 1978, §7-9-61.1. NMSA 1978, §7-9-61.1 states, "Receipts from charges made in connection with the origination, making or assumption of a loan or from charges made for handling loan payments may be deducted from gross receipts."

AFT claims that the receipts from the surcharge fees are charges made resulting from loans or in connection with the making of loans to banks. AFT also claims that while it does not have a traditional written loan agreement between it and the banks, that it has an oral loan agreement such that when a bank's customer utilizes AFT's ATMs to withdraw money, that the bank, not its customer, is responsible for paying both the reimbursement of the money disbursed and the surcharge fee. Therefore, according to

AFT's argument, there is a loan between AFT and the bank and the surcharge fees are receipts made in connection with the loan, the receipts are deductible from gross receipts.

Both parties cite *Security Escrow Corp. v. State Taxation and Revenue Dept.,* 107 N.M. 540, 760 P.2d 1306 (N.M. App. 1988) in support of their claim. In *Security Escrow* the issue was whether Real Estate Contracts constituted a loan such that receipts from charges for handling payments made pursuant to the contract could be deducted from taxpayer's gross receipts. The court defined "loan" as "something lent for the borrower's temporary use on condition that it or its equivalent be returned. Case law has defined a loan as a delivery of a sum of money to another under a contract to return at some future time an equivalent amount with or without an additional amount agreed upon for its use." *Id.* at 544. The court additionally, explained the four elements of a loan as:

> (1) a principal sum; (2) a placing of the sum with a borrower; (3) an agreement that interest is to be paid; and (4) a recognition by the receiver of money of his liability for return of the principal amount with accrued interest…In a loan, the initial transaction creates a debit and credit relationship that is not terminated until replacement of the sum borrowed with agreed interest….

Here, as AFT is an ISO and not a bank or financial institution, in order to conduct business with Networks such as MasterCard and Visa, it must be sponsored into the Networks by a financial institution. Further, when a customer attempts to withdraw cash from the ATM, their account is located to ensure that the customer has the funds prior to disbursement of cash. If the customer does not have adequate funds to cover the withdrawal of the cash the withdrawal is denied. Therefore it is the customer seeking to withdraw cash from the ATM whose money is taken from their account by the bank and thereafter reimbursed to AFT. The bank's funds are not at risk. The bank cannot be deemed to be a "borrower." The customer's bank account is charged not only for the cash withdrawn but also for the surcharge fee. If this was truly a loan to the bank, there would be no need to verify money in a customer's account nor would the withdrawal or denial be based on whether the customer had sufficient funds in his/her account but rather the bank would borrow the money based on its own financial stature and be solely responsible for payment of both the amount withdrawn and the surcharge fee to AFT.

In this instance the principal sum is the amount each customer wishes to withdraw from their account. If the bank is the borrower then the funds should be distributed to the bank rather than to its customer. If, as AFT suggests, the bank was truly the borrower, AFT would verify the bank's funds rather than the customer's funds to ensure that sufficient funds existed to support the requested transaction.

Additionally, there is no agreement that AFT will receive interest on the transaction. Rather, when a customer asks to withdraw a sum certain it is prompted by AFT's ATM seeking a response as to the customer agrees to pay the designated surcharge fee from his/her account. Only if the customer agrees to AFT's surcharge fee and the customer's account has sufficient funds to cover the withdrawal will the ATM dispense the requested money. Even if the customer agrees to the surcharge fee, the transaction may still be declined if a check of the customer's bank account information reveals insufficient funds to cover the withdrawal and the surcharge fee. Here, the customer acknowledges that for immediate cash in hand at the retail location, the amount of the cash withdrawn and the surcharge fee will be deducted from the customer's bank account. While the bank is performing a bank function to transfer funds owed from its customer to AFT, there is no evidence that the surcharge fees are based on loans or made in connection with loans to the banks.

In *Security Escrow* the court ultimately determined "that the legislature intended to allow the deduction from gross receipts under the statute [§7-9-61.1] only for typical loan transactions involving both a traditional lender and borrower." *Id*. at 545. The withdrawal of cash by a customer at an ATM owned by an ISO whereby a bank deducts from the customers account both the cash withdrawn and the surcharge fee, cannot be labeled as a typical loan transaction. It is more comparable to a customer writing a check to pay a credit card bill with the bank paying the bill to the credit card company with the customer's funds. The bank is not loaning the customer or the credit card company money but is simply using the check as permission to shift funds from the customer's account to the third party, the credit card company. The transaction is not between the bank and AFT but is between AFT and the bank's customer.

The arrangement between AFT, the banks and its customers cannot be construed as a simple case of a short term loan between AFT and the bank as just because the bank actually pays the amount to AFT the bank is not using its funds to pay the fees and reimbursement of cash to its customer's to AFT but rather in most cases is using its customer's funds, which it has taken from the customer's accounts when the customer received the cash. The evidence established that in some instances the bank will reimburse the customer for the amount of the surcharge fee however that is an accommodation between the bank and its customer and has nothing to do with the charge of the fee by AFT or the deduction from the customer's bank account for the surcharge fee.

Citing *State ex rel Mountain States Mutual Casualty Co. v. KNC, Inc.* 106 N.M. 140, 740 P.2d 690 (1987), AFT argues that the agreement between AFT and the banks are receipts in connection with the making of a loan. *Mountain States* defines, "in connection with" as "attached to", "associated with" or "incident to". Id at 141. The actions of AFT can be defined as associated with, attached to or incident to the transaction as established above. However, the relationship between AFT and the banks is not one of lender and borrower but rather the bank collecting money from a customer for reimbursement of cash provided the customer with an attending surcharge fee for the service provided.

Counsel for AFT argued that §7-9-61.1 applies to overdraft protection services arguing that such establishes that it is not limited to traditional loans. Regulation 3.2.219.9 (A) states, "A charge by a bank or other financial institution with respect to an honored commitment (using funds other than the depositor's to cover an overdraft) are charges made in connection with the origination, making or assumption of a loan and are deductible under Section 7-9-61.1 NMSA 1978." The allowance is for use of other than a depositor's funds. In this instance, the funds for both the cash withdrawal and the surcharge fee are deducted immediately from the customer's bank account. Therefore the overdraft protection service is deductible when the funds expended are not the depositor's funds. In this instance the funds expended are those of the depositor's.

Also, Regulation 3.2.219.10 states, " Fees charged by a bank or other financial institution from transferring funds from one account to another of that same depositor are not charges made in connection with the origination, making or assumption of a loan, even if the transfer is made to cover an overdraft in one of the accounts. Such charges are not deductible under Section 7-9-61.1. NMSA 1978." While this regulation is specific as to fees charged by a bank or financial institution, the act of transferring funds is analogous to the actions of AFT in that the surcharge is in return for the transfer of funds from the bank account of a customer into immediate cash. The regulation clearly states that fees charged for transferring funds are not deductible under §7-9-61.1.

AFT is not entitled to the deduction pursuant to NMSA 1978, §7-9-61.1 as the surcharge fee is not receipts from charges made in connection with the origination, making or assumption of a loan or from charges made from handling loan payments. Therefore AFT is liable for gross receipts tax on receipts from its activities and charges paid in allowing customers to withdraw cash from their ATM when the customer's bank account evidences sufficient funds to cover both the withdrawal of the cash and the surcharge fee. AFT has failed to carry its burden of proof to clearly and unambiguously establish the right to the deduction or to establish that the assessment is incorrect.

Interest Due on Unpaid Principal. NMSA 1978 Section 7-1-67 (2007) governs the imposition of interest on late payments of tax and provides, in pertinent part:

> A. If a tax imposed is not paid on or before the day on which it becomes due, interest *shall be paid* to the state on that amount from the first day following the day on which the tax becomes due, without regard to any extension of time or installment agreement, until it is paid... (emphasis added).

NMSA 1978, Sec.7-1-67(A) (2007). The legislature's use of the word "shall" indicates that the assessment of interest is mandatory rather than discretionary. *State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977). The legislature has directed the Department to assess interest whenever taxes are not timely paid. The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Even taxpayers who obtain a formal extension of time to pay tax are liable for interest from the original due date of the tax to the date payment is made. *See*, NMSA 1978, § 7-1-13(E) (2007).

Interest must be assessed on tax that is due, and continues to accrue until the principal amount of tax is paid. In the acknowledgment letter of July 19, 2007 from the Department to Mr. Rafael Gutierrez and AFT, the Department notified Mr. Gutierrez and AFT that interest would continue to accrue on any unpaid balances of principal. See Department Exhibit D. The letter also informed Mr. Gutierrez and AFT that it could make payment on a "protested assessment to stop the accrual of interest." Department Exhibit D. Mr. Gutierrez and AFT certainly had sufficient notice that interest would continue to accrue on any unpaid principal tax due. As the principal amount was not paid, interest on the tax is also due and owing.

CONCLUSIONS OF LAW

A. AFT filed a timely, written protest to the assessment of gross receipts tax issued under Letter ID No. L0297207424 and jurisdiction lies over the parties and the subject matter of this protest.

B. The fees collected by AFT from ATM users is received for providing services that are subject to New Mexico Gross Receipts Tax pursuant to NMSA 1978, §7-9-1*et seq.*

C. The fees collected by AFT from ATM users to receive cash based on funds in their bank accounts are not receipts from charges made in connection with the origination, making or assumption of a loan or from charges made for handling loan payments. Therefore AFT is not entitled to deduct those fees from their taxable gross receipts pursuant to NMSA 1978, §7-9-61.1.

D. Pursuant to NMSA 1978, §7-1-67 (2007), having not paid the taxes due by the statutory due date, taxpayer is liable for the interest assessed by the Department, which continues to be applied until the principal tax is paid in full.

For the foregoing reasons, the protest of Automated Financial Technologies, AFT, is HEREBY DENIED.

Dated: October 14, 2010.